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SUBJECT: INVESTMENT CLIMATE STATEMENT, 2009 - MALDIVES

REF:

1. Per reftel, below is the investment climate statement for Maldives for 2009.

INVESTMENT CLIMATE STATEMENT-MALDIVES

JANUARY 2009

Investment Climate

--Introduction

Maldives is comprised of over 1,190 islands, of which 198 are inhabited and 95 are exclusive resort islands. The population is approximately 300,000, 103,000 of which live on the capital island of Male'. There are an additional, on average, 80,000 expatriate workers. More than 680,000 tourists arrive annually. In 2008 GDP totaled around \$1.2 billion, or about \$3,900 per capita (far exceeding the average of about \$700 in the rest of South Asia). Throughout the past decade, real GDP growth averaged around 6% per year except for 2005, when GDP declined following the Indian Ocean tsunami. GDP growth was 5.7% in 2008. Economic growth has been powered mainly by tourism and its spin-offs in the transportation, communication, and construction sector. Fishing remains an important part of the economy as well. While income disparity remains high, particularly between the capital and distant islands, Maldives' growth has yielded considerable social progress. The net enrollment in primary education is close to 100%. Literacy rates are about 98%. Infant and maternal mortality are declining rapidly.

The Indian Ocean tsunami in December 2004 devastated many islands, with damage estimated at \$450 million. The Maldivian economy made a remarkable recovery, with a rebound in tourism, the development of new resorts, and post-tsunami reconstruction helping the economy in the ensuing years. Nevertheless, recent growth, while significant, has come at the cost of extremely high budget deficits and mounting external debt. Since 2004, government spending has increased rapidly. According to preliminary information, government expenditure rose to an unprecedented 70% of GDP in 2008. Consequently, the budget deficit expanded to 10% of GDP. The IMF and other international donor agencies have urged the government to return to fiscal prudence quickly to ensure economic stability.

2008 was a year of significant change in Maldives. The country

launched a new constitution and a series of new laws, including the first comprehensive employment act. On October 8, 2008, Maldives held its first multi-party Presidential election. The new President, Mohamed Nasheed, has vowed to put the country's economic and fiscal matters in order. He has also pledged to establish a transportation network linking the islands of the country, bring down the cost of living, provide affordable housing and healthcare, and eliminate illegal narcotics.

It will take some time for the new government to settle in. There are still significant gaps in the necessary legislation to implement the reforms embodied in the new constitution. Parliamentary elections due by mid-February 2009 under a constitutional deadline have been delayed until May.

The government is expected to revise its 2009 budget -- passed in late 2008 -- early in the year in an effort to reign in fiscal control. The government is actively promoting foreign investment. Meanwhile, the global economic crisis is likely to dampen economic prospects for 2009. Tourism and fisheries, key economic sectors, are challenged by the global recession.

The Maldives Monetary Authority (Central Bank) expects GDP growth around 4.5% in 2009. Maldives' trade deficit has expanded sharply in recent years as a result of high import prices for oil and construction materials. In 2008, the trade deficit reached an estimated \$900 million. The deficit was partially offset by tourism and government borrowing. The current account deficit was \$637 million. The balance of payments recorded a deficit of about \$72 million in 2008. Total external reserves stood at \$241 million in December 2008 (2.1 months of imports). External debt and debt

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service have risen rapidly in recent years. Total external public debt was \$477 million in 2008 and is likely to surpass \$750 million in 2009. A foreign exchange shortage affecting businesses was reported as of March 2009.

Maldives is ranked 69 out of 181 countries in the World Bank's (www.worldbank.org) Ease of Doing Business 2009 Index, ahead of its South Asian neighbors. The index investigates regulations that enhance or constrain business activity. Within the index, Maldives ranked first in terms of paying taxes (Maldives has no income or sales tax), fourth in employing workers, and eighth in dealing with construction licenses. But in terms of registering property, getting credit, and closing a business, the country ranked lower, at 177, 145, and 123, respectively. Other rankings were as follows: starting a business 38, protecting investors 70, trading across borders 121, and enforcing contracts 90.

Maldives is seeking to postpone its "graduation" from Least Developed Country (LDC) status, currently scheduled for 2011. The graduation would reduce the country's ability to access concessionary trade and finance programs, and poses the threat of demise of the fish export industry and the curtailment of foreign aid.

Tourism will likely remain the engine of the economy. As many as forty new resorts could open in the next few years, with at least two planned openings in 2009.

In 2007, the government presented the Seventh National Development Plan, which will guide development from 2006-2010. The plan outlines Maldives' goals to further improve tourism, develop infrastructure, improve social protection and modernize education to achieve development goals. In 2008 Maldives plans to adopt a regional development policy to improve atoll infrastructure and services, and to consolidate populations to a few large population centers.

The United Nations Development Program (UNDP) (www.mv.undp.org), the World Bank (www.worldbank.org), and other multilateral and bilateral donors are active in Maldives. They support government efforts to improve education, health and nutrition, housing and social protection, basic infrastructure, create employment opportunities, environmental protection and improved governance. The United States

has friendly relations with Maldives.

--Openness to Foreign Investment

Foreign investment in Maldives is governed by Law 25/79, which provides for an agreement between the government and an investor. The Law of Contract governs contractual relationships and a separate law (No. 4/79) governs business and trading activities by foreign nationals. Investment agreements are for an initial period of 5 to 10 years for investments less than \$1 million, and can be renewed thereafter. For larger projects, terms are negotiable.

Maldives began opening up to foreign investment in the late 1980s. Foreign investments in Maldives have primarily involved resort management, but also include telecommunications, accounting, banking, insurance, air transport, courier services, and some manufacturing. Invest Maldives Division (www.investmaldives.org) and the Licensing and Regulations Division within the Ministry of Economic Development are tasked with promoting and regulating foreign investments respectively, with the notable exception of the tourism sector. The Ministry of Economic Development reviews all proposed investments prior to granting licenses. The Ministry of Economic Development offers "one-stop shop" services to investors and incentives including import duty concessions, 100% foreign ownership, no restrictions on repatriation of earnings or profits, and no foreign exchange restrictions. Foreign investments are required to pay annual royalty fees to the government. The royalty fee is 3% of gross income or 15 percent of profits, whichever is greater, for majority foreign-owned companies. For others, the royalty is 1.5 percent of income or 7.5 percent of profits, whichever is greater. At present, personal income taxes are not imposed. Banks' profits are taxed and a corporate profit tax is under discussion. International arbitration is available for dispute settlement. Foreign investments within the tourism sector -

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such as resorts - are registered with the Ministry of Tourism, Arts and Culture.

The Ministry of Economic Development approves joint ventures in the following sectors within ten working days of submitting required documentation: financial consultancy, auditing, insurance, water sports, commercial diving, domestic air transport, airline catering, game fishing, technical support services, apparel manufacturing, water bottling, cement, agencies, spa operators, water purification, boat building, software development, ferry services, finance leasing, fish processing, traditional medicine, underwater photography, ice making, restaurants, valuation, flying schools and IT services. Proposals for joint ventures in other sectors and investments fully owned by foreigners are approved within 30 days.

The government hopes to privatize airports and harbors and develop basic services such as water, sewerage systems, harbors, roads and power utilities through public private partnerships.

The Ministry of Economic Development is looking for local and foreign investors in media and broadcasting, entertainment industry, utilities, infrastructure, health care facilities, hospital management, regional airport management, and the development of residential infrastructure (vacation homes).

The Ministry of Economic Development encourages investment projects which: (1) are capital intensive; (2) enhance technology transfer; (3) introduce new skills and offer training to local employees; and, (4) are environmentally friendly.

The following industries offer good potential for foreign investors:

Tourism: Opportunities exist in the entire range of services, including development and management of resorts, tourist activities, and land and sea transportation.

Value-Added Fisheries: Fish processing is open to foreign investment, particularly for new technology and capital investment.

Financial, banking, accounting, and management consulting: The FIBS is interested in bringing in more global banks. (Only HSBC is currently present). The lack of adequate banking laws has deterred entry, however.

Transportation and Shipping: Development of air and sea transport including inter-atoll transport services, bunkering, transshipment, and passenger cruises. Male' International Airport is the main gateway to Maldives. In December 2007, the airport in Gan Island in the south was upgraded to accommodate international flights. Of the 198 inhabited islands in the Maldives, 105 have harbors. Other key priorities in the transport sector are the expansion of the Male' Airport and the Male' Commercial Harbor, the development of a transshipment port, a bridge connecting the capital city Male' with the airport island Hulhumale, and a new commercial port in the Male' region.

Population Consolidation: The government is planning two major development plans in the area of population consolidation. The first is a consolidation of the services and infrastructure of 20 atolls around five regional centers. The second is a project to alleviate overcrowding in Male' by developing nearby Hulhumale Island, where Male's international airport is located.

Telecommunications and information technology also offer potential opportunities.

Power: Currently, virtually all electricity is provided by diesel generators. Tourist resorts consume about 60 percent of electricity used in the Maldives. There is scope to provide renewable sources such as solar, wind and biomass for energy needs; pilot projects in these areas are underway on some islands.

Retail trading is closed to foreign investment. The production of any items that are illegal to import into Maldives is prohibited.

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--Conversion and Transfer Policies

There are no exchange controls or restrictions on currency movements. Repatriation of funds and profits is allowed after local debts are settled.

Major international currencies can be bought and sold at banks and authorized moneychangers. Hotels and banks accept major credit cards and travelers checks. Foreign currency accounts are available through banks. The US dollar is the most widely used foreign currency and is accepted by small shops and taxi drivers in Male'.

The official exchange rate is set at 12.8 Rufiyaa to the dollar. This rate has remained unchanged since 2001. The Maldivian currency is non-convertible and its true value cannot be determined. The government has noted that it will need to review the exchange rate policy in the next few years in order to promote export diversification. The heavy dependence on imports is a constraint for exchange rate management, although tourism receipts help maintain hard currency liquidity. A foreign exchange shortage affecting businesses was reported as of March 2009. Large fiscal deficits financed by the Maldives Monetary Authority (www.mma.gov.mv) pose a potential threat to the fixed exchange rate system.

Foreign reserves at the end of December 2008 were \$241 million, down from \$309 million in 2007, and were sufficient to finance 2.1 months of imports.

The government has taken initial action to introduce a new public accounting system. A new Public Finance Law, an Audit Law and a Civil Service Law came into force in 2006-2007. Legislation on Anti-Money Laundering and Combating Terrorist Financing has been drafted.

--Expropriation and Compensation

According to the Law on Foreign Investment (25/79) the government may, with or without notice, suspend an investment, either where the investor indulges in an act detrimental to the security of the country or where temporary closure is necessary for national security. If, after due investigation, it cannot be concluded within 60 days of the temporary closure that the foreign investor had indulged in an activity detrimental to the security of Maldives, then the government will pay compensation. Capital belonging to an investment that is closed for the above reasons may be taken out of the country in a mutually agreed manner. There appears to be little risk of expropriation in the near future.

--Dispute Settlement

The sources of law in Maldives are its constitution, Islamic Sharia law, regulations, Presidential decrees, international law, and English common law, with the latter being more influential in commercial matters. The Judicial Services Commission (JSC) is responsible for nominating, dismissing, and examining the conduct of all judges.

A Supreme Court was established for the first time in 2008 under the new Maldives Constitution. The Supreme Court is the highest judicial authority in Maldives. In addition to the Supreme Court, there are four courts in Male': a high court, civil court, criminal court, and a family and juvenile court. There are approximately 200 magistrate courts, one in each inhabited island. The Supreme Court serves as court of appeal. There are no jury trials. Though legal procedures are adequate, the judicial process is slow.

Pursuant to the new constitution, a prosecutor general was appointed in September 2008. The prosecutor general is tasked with the prosecution of criminal offences. The Attorney General acts as the legal advisor to the government and represents the government in all courts except on criminal proceedings represented by the prosecutor general.

The law on foreign investments guarantees the security of

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investments. Maldives has no laws pertaining to arbitration. Disputes involving investments below \$1 million can be referred to the courts in Maldives. Disputes over \$1 million can be referred for international arbitration.

Recognizing that the existing legal and commercial framework is underdeveloped and not always fully transparent or predictable, the government is promoting administrative reforms and formulating regulations dealing with labor, the environment and industry. In recent years, the People's Majlis (parliament) has enacted a number of commercial laws, including the Law of Contract, the Negotiable Instruments of Law, and the Companies Act. Maldives is not a member of the International Center for the Settlement of Investment Disputes (ICSID).

--Right to Private Ownership and Establishment

There is little private ownership of land. Land reform currently under consideration may result in more trade and private ownership of property. Foreign investors are not allowed to own land, but are granted lease rights ranging up to 25 years, which can be later extended to 35 years for investments over \$10 million, or 50 years if 50% of the company's shares are floated on the Maldives stock market. Leases can be renewed at the end of their terms, but the formula for assessing compensation value of a resort at the end of a lease has not yet been developed. The government is looking at the possibility of extending the initial lease period from 25 years to 99 years.

--Protection of Property Rights

Currently, Maldives lacks specific legislation to protect intellectual property rights (IPR) and has not signed any related international agreements or conventions. An IPR law is awaiting

parliamentary approval. Maldives recently established an IPR unit within the Ministry of Economic Development. Maldives benefits from the World Trade Organization (WTO) decision to extend the transition period for least-developed countries (LDC) to provide protection for intellectual property under the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement until July 1, 2013.

--Efficient Capital Markets and Portfolio Investment

The financial sector in Maldives is narrow and dominated by the banking sector. The banking sector consists of one publicly owned commercial bank -- the Bank of Maldives -- and branches of four foreign-owned commercial banks. HSBC, the only global bank present, set up operations in 2002. Non-bank financial institutions in the country consist of two insurance companies, a pension fund, and a finance leasing company. All financial institutions currently operate under the supervision of the Maldives Monetary Authority, which acts as the central bank. The Maldives Monetary Authority Act was amended in 2007 to ensure independence of the Authority.

Local sources of finance are limited in scope because of the small size of the capital market and the lack of instruments that are available in more developed nations. The government commenced treasury bill auctions in 2006. Other types of financial instruments are not offered to the public. The commercial banks provide short- and long-term credit to the private sector. No specialized financial institution exists to meet the investment needs of tourism, agriculture and fisheries. Non-performing loans fell to 2.4% of total loans in 2006 from about 6.7% in 2005 due to a recovery in tourism and to improved banking supervision. Most foreign currency loans are made to foreign currency-earning tourist enterprises. Banking supervision has recently been upgraded, moving toward international best practices.

A small Securities Trading Floor (STF) opened in Male' in 2002 and was licensed as a private stock exchange in 2008. In 2006, the government took several steps to enhance the capital market. The legislature passed a Securities Act in January 2006 and the government created a Capital Market Development Authority (CMDA) to regulate the capital market. The STF now functions under the CMDA. At present, the only investment opportunity available to the public is a limited number of shares in the Bank of Maldives and three other state-owned public companies. A leasing company, Maldives

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Finance Leasing Company (Pvt) Ltd (MFLC), was established in May 2002 as a collaborative venture between five domestic public and private sector entities and two international parties including the World Bank's International Finance Corporation (IFC). The MFLC aims to address the demand for long-term equipment financing from all sectors of the economy.

The Housing Development Finance Corporation is a government company designed to provide housing loans with long repayment terms at favorable interest rates. The company is also entrusted with drawing up the land use policy in Maldives.

--Political Violence

Maldives has a homogeneous society of one culture, one religion, and one language. In 2008, Maldives held its first multi-party Presidential elections, following a multi-year effort for constitutional reforms. President Nasheed took office in November 2008, replacing a thirty-year incumbent. The transition to a new government led by the former head of the opposition was peaceful. Political rallies in Maldives generally do not turn violent, as sometimes occurred under the previous regime.

Religious extremism, involving espousal of fundamentalist views incompatible with Maldives' generally moderate Islamic practices, is a growing trend. In September 2007, Maldives experienced its first-ever terrorist attack when a bomb exploded in the capital of Male', injuring twelve tourists, who appeared to be the target of the attack.

--Corruption

Corruption is a serious problem in Maldives, and the new government has vowed to fight it. The World Bank's Control of Corruption Index for Maldives shows a steady decline in recent years from +0.06 in 2003 to -0.15 in 2004, -0.32 in 2005, -0.51 in 2006 and -0.78 2007. Transparency International's Corruption Perception Index surveyed Maldives for the first time in its 2007 index and Maldives ranked 84 with a score of 3.3 out of a possible 10. In 2008, Maldives slipped 31 places and ranked 115 out of 180 countries with a score of 2.8.

The law on prevention and punishment of corruption (2002) defines bribery and improper pecuniary advantage and prescribes punishments.

The law also outlines procedures for the confiscation of property and funds obtained through commission of the included offenses. An Anti-Corruption Commission was created in December 2008 following the passage of the Anti Corruption Commission Act. The responsibilities of the Commission include inquiring into and investigating all allegations of corruption; to recommend further inquiries and investigations by other investigatory bodies; and to recommend prosecution of alleged offences to the Prosecutor General, where warranted. The Anti-Corruption Commission is empowered to handle cases of corruption of members of parliament. It cannot investigate corruption in the private sector.

In March 2007, the Maldives acceded to the United Nations Convention against Corruption.

--OPIC and Other Investment Insurance Programs

Currently, the Overseas Private Investment Corporation (OPIC) does not operate in Maldives. Maldives is not a member of the Multilateral Investment Guarantee Agency of the World Bank Group.

--Labor

Skilled and unskilled labor is scarce, and expatriate labor is allowed in order to meet shortages. There are an estimated 80,000 expatriate workers, mostly in tourism, construction, and social and personal services. Expatriate labor is equal to or more expensive than local labor. Even when salaries are set lower, travel and other benefits typically make it more expensive overall to hire expatriates. Since higher education options in Maldives are limited, young Maldivians from higher income families often travel abroad for education.

The laws covering labor were overhauled in 2008 with the enactment

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of the 2008 Maldives Constitution, the new Employment Act, and a subsequent amendment to the Employment Act. The new constitution recognizes the workers' right to strike and establish trade unions, for the first time. Maldives is hoping to enact a separate trade union law providing rules for formation of trade unions and collective bargaining.

The Employment Act provides for the establishment of minimum wages, maximum hours of work, overtime, annual and sick leave, maternity leave and work place safety.

The Employment Act created a 48-hour/week with a compulsory 24-hour break after six days of continuous work. Resort workers may accumulate the weekly rest day. Overtime is available. Workers in tourist resorts may work additional two hours a day and paid at overtime rate. Employees are usually authorized 30 days of annual leave, 30 days of medical leave, 65 days of maternity leave, and 10 days of special annual leave to "attend important obligations." Either parent of a newborn child is entitled to one year's unpaid annual leave after the expiry of the maternity leave period. Employers are also required to provide a safe workplace. The law provides for entering into of agreements between the employer and the employee which guarantees the rights specified in the law.

Until recently, the government did not recognize the right to form unions or the right to strike. Hence, labor actions and disputes were rare. While no labor unions yet exist, collective bargaining involving employees' associations in the tourism sector began within

days of the new constitution taking effect. Labor disputes arose in some resorts when employees' associations presented demands for wage increases and improvements in the conditions of work and stopped work.

Traditionally, wages in the private sector have been set by a contract between employers and employees and were based on rates for similar work in the public sector. The new employment law established a Pay Advisory Board to advise the Minister of Human Resources, Youth and Employment on setting minimum wages in the private sector.

The Employment Act granted workers the right to compensation if fired without cause. The government has established a Labor Relations Authority to implement the new employment law. The law requires the Ministry of Human Resources to issue specific rules for employment of foreign workers.

The Employment Act does not cover emergency workers, air and sea crews, executive staff of any company and persons on on-call duty.

In December 2008, following the enactment of the new Employment Act, Maldives became a member of the International Labor Organization. In 1995, the United States suspended Maldives' eligibility for tariff preferences under the US Generalized System of Preferences (GSP) because the Maldives did not have a mechanism to afford internationally recognized worker rights to Maldivian workers.

--Foreign Direct Investment Statistics

Foreign Investment: US firms represented in Maldives include Western Union, FedEx, UPS, Hewlett Packard (HP), Dell, Compaq, Coca-Cola, American Express, Hilton Resorts, Sheraton, SeaTec, Ernst and Young, PricewaterhouseCoopers, and KPMG.

--Web Resources

Foreign Investment Services Bureau: www.investmaldives.org
International Monetary Fund: www.imf.org
World Bank: www.worldbank.org
Ministry of Planning and National Development: www.planning.gov.mv
Maldives Monetary Authority: www.mma.gov.mv
Maldives Stock Market: www.maldivesstockexchange.com.mv
United Nations Development Program: www.mv.undp.org